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¶1. (U) Summary. This is Volume 8, issue 38 of U.S. Embassy
Pretoria's South Africa Economic News Weekly Newsletter.

Topics of this week's newsletter are:
- Weaker Rand, More Inflation Likely for SA
- No Surprises in SARB Governor's Speech
- SA Falls in Economic Freedom Ranking
- SA R&D Expenditure Rising
- Textile Group Pleads to Keep China in Check
- Sanlam Establishes Joint Venture with
  Leading Indian Brokerage House
- State 'Loses Sense of Urgency on BEE'
- SAA Increases Service to Germany
- Auto Industry Needs to Improve Global Competitiveness
- Major Development Projects in Cape Town
- Decision on Nuclear Project in Progress
- Eskom to Unveil First Cogen Projects
- PPC Hopes to Expand Plant in Western Cape
- SA Lays Out Its Hydrogen Economy
- Cisco Builds ICT Innovation Center
End Summary.

Weaker Rand, More Inflation Likely for SA

¶2. (U) Industry analysts report that a prolonged global financial crisis could curb capital inflows to South Africa and weaken the rand. The good news is that the financial sector, which makes up a 20% of South Africa's economy, is not heavily exposed to the offshore credit lines snapped by the collapse of Lehman Brothers. The bad news is that if the rand depreciates further, the trend will re-ignite local inflation and delay the interest rate cuts that markets had expected next year. It would also postpone a recovery in economic growth, which is expected to slow to just above 3% this year, from just over 5% last year. If global investors remain risk averse, it will be difficult for South Africa to attract the capital needed to finance its huge current account deficit. That would put pressure on the rand, which has already depreciated about 15% against the dollar this year. A continued decline of mineral prices would also erode the value of exports and widen the deficit. The main threat is whether the U.S. economy tips into a recession and how this will affect emerging giants such as China. (Business Day, September 16, 2008)

No Surprises in SARB Governor's Speech

¶3. (U) South African Reserve Bank (SARB) Governor Tito Mboweni reiterated the SARB's commitment to price stability during a speech to shareholders at the SARB's annual general meeting on September ¶18. Mboweni also said that South African banks had little direct exposure to the U.S. subprime market. He highlighted the fact that the cumulative 500 basis-point hike in interest rates since June 2006 has contributed to a slowdown in household consumption spending growth and a widening of the output gap, which aided in reducing the risks to the inflation outlook. That, together with lower international oil prices, prompted the SARB to leave interest rates unchanged at the August meeting of the Monetary Policy Committee. However, Mboweni warned that despite the more positive outlook, the SARB remains concerned over rising inflation expectations, stating that "... to prevent second-round effects, it is important that expectations remain well-anchored. Failure to respond appropriately Qexpectations remain well-anchored. Failure to respond appropriately could inevitably cause expectations to become dislodged and result in a further acceleration in inflation." (ABSA Capital, September 19.)

SA Falls in Economic Freedom Ranking

¶4. (U) South Africa fell from 49th to 54th place out of 141 countries in the latest annual Economic Freedom of the World Report. Judiciary independence and impartiality both rated lower in the report, which compared data collected in 2006 with that of the previous year. The report measures economic freedom by considering factors such as government size, legal system, regulatory environment (credit, labor, and business), and access to "sound"

money that is not eroded by inflation or hindered by foreign exchange controls, and freedom to trade internationally. Free Market Foundation Executive Director Leon Louw said, "The single most important factor in economic growth is the legal system." (Business Day, September 17, 2008)

SA R&D Expenditure Rising

¶5. (U) The Human Sciences Research Council (HSRC) recently released its annual national survey on research and development (R&D) expenditure in South Africa. The survey revealed that R&D expenditure increased from R14.1 billion ($1.8 billion) in fiscal year 2005/2006 to R16.5 billion ($2.06 billion) in fiscal year 2006/2007. Department of Science and Technology (DST) Director-General Dr. Phil Mjwara noted that this put South Africa on course to meet its goal of spending 1% of gross domestic product on R&D by fiscal year 2008/2009. Mjwara added that the increasing R&D expenditure was an indication of the country's growing participation in and progress towards a knowledge-based economy. The survey indicated that most R&D was performed in engineering sciences (20.9%), followed by the natural sciences (20.3%), higher education (20%), and the medical and health sciences (15.1%). Mjwara said the survey also revealed that the local business sector was the major performer and financer of R&D, financing 51.3% of total R&D. Only 10.6% of the R&D was financed from abroad. The survey was commissioned by the DST and included comprehensive polling of business, government (including the nine science councils), higher education, and non-profit organizations. (BuaNews, September 17, 2008)

Textile Group Pleads to Keep China in Check

¶6. (U) Textile and clothing bodies from 17 countries, including South Africa, have urged the U.S. to protect industries and tighten monitoring procedures when its quota limits on Chinese garments and

textiles expire next year. The bodies were concerned that export markets could be overrun by cheap Chinese products. Textile Federation of South Africa President Abisha Tembo and Export Council for the Clothing Industry Chairman Jack Kipling were among the signatories of a letter to U.S. trade representative Susan Schwab and the U.S. Senate and House of Representatives last week. When quotas on the products now under safeguard were temporarily lifted in 2005, Chinese manufacturers reduced prices by 40%, which led to a 600% increase in Chinese imports to the U.S. This triggered the imposition of the safeguards that will expire next year. "As in 2005, the stakes at risk are enormous for export sectors in Africa, Central America, the Middle East, the Andean region and Mexico. The safeguards have preserved $37 billion worth of trade in exports, and helped keep ... one million jobs. In non-safeguard areas the story is much different ... where billions of dollars in business have been lost to China and its unfair trade practices," the letter said. The U.S. is an attractive market for developing country apparel and textile exports. However, China has taken 60% of the U.S. market
Qtextile exports. However, China has taken 60% of the U.S. market
share in product segments where imports are not limited by quotas. (Business day, September 18, 2008)

Sanlam Establishes Joint Venture with
Leading Indian Brokerage House

¶7. (U) Sanlam Investments took a strategic step into the fast-growing Indian market by establishing a joint venture with India's fourth-largest securities house SMC. Sanlam Investments will contribute $22.5 million to capitalize the ventures. Sanlam Investments CEO Johan Van der Merwe said this was the first step in its Indian investment strategy and would be a springboard for further expansion in the subcontinent and synergies with Sanlam's other businesses. SMC is one of India's fastest-growing retail brokerage houses, with a national network of more than 1,350 offices. SMC CEO Subhash Aggarwal reported that its customer base topped 400,000 and rose by 10,000 on a monthly basis. Sanlam said India had "massive untapped potential", with $2 trillion in cash deposits in a country where more than 90% of potential investors did

not use financial market instruments. India's national savings rate is about 30%, and is supported by a rapidly rising middle-class and income standards. "Our projections show that if we capture only between 2% and 5% of the expected $1 trillion market by 2015, our business in India could contribute a significant portion to group profits," Van der Merwe noted. (Business Day, September 17, 2008)

State 'Loses Sense of Urgency on BEE'

¶8. (U) National Empowerment Fund (NEF) Chairman Ronnie Ntuli lamented that the South African government seems to have lost its sense of urgency on Black Economic Empowerment (BEE) on a macro scale. Ntuli's comments echoed those of Employment Equity Commission Chairman Jimmy Manyi, who said the employment equity law was failing to change the workplace significantly. "While many development finance institutions are making concerted efforts to create the implementation tools needed for economic transformation, new energy is necessary at a macro level. Strategies had to create black-owned enterprise, and include more black people in the economic mainstream." Manyi said. Ntuli urged a shift away from a model which only bought in "small, tight-knit black groups into existing white-owned firms." There was also a "massive need" for new black enterprises to be created and grown. One possibility would be for the NEF to become more closely linked to the Department of Trade and Industry in terms of black empowerment across all industrial development sectors, and to more effectively identify trade opportunities for black empowered businesses. (Business Day, September 18, 2008)

SAA Increases Service to Germany

¶9. (U) South African Airways (SAA) announced that it would expand to daily flights between Johannesburg and Munich starting October 1. SAA decided to increase flights from four to seven flights a week to meet growing demand. SAA also recently increased service from seven to ten flights per week between Johannesburg and Frankfurt. (Engineering News, September 18, 2008)

Auto Industry Needs to Improve
Global Competitiveness

¶10. (U) Volkswagen South Africa (VWSA) welcomed the announcement of the structure and content of the new Automotive Production and Development Program (APDP), following "lengthy deliberation and many delays". "The industry can now plan ahead through to 2020 with a much greater degree of certainty," said VWSA CEO David Powels. However, Powels asserted that the South African motor and component manufacturing industry has "a long road to travel" before it can claim global competitiveness. In terms of cost competitiveness, he believed that there is an approximate 20% lag compared with manufacturers in Western Europe. "This gap widens to between 30% and 40% when comparing South African manufacturing cost structures with those in emerging automotive power-houses such as India and China," warned Powels. He advocated for increased investment in new technologies, increased manufacturing depth, and skill development Qtechnologies, increased manufacturing depth, and skill development "in order to grow the local content in vehicles manufactured in South Africa." The automotive industry is strategically important to South Africa, contributing about 7% to gross domestic product and accounting for 16% of total exports. (Engineering News, September 19, 2008)

Major Development Projects in Cape Town

¶11. (U) Cape Town Mayor Helen Zille announced new developments amounting to about R30 billion ($3.8 billion) for the Cape Town central business district in the next three to five years. Two-thirds of the investments are from the private sector. Zille said that the Cape metro region as a whole was expected to see 9.5% growth in fixed investment in the medium-term. According to Zille, public investments included the R2.5 billion ($300 million) airport upgrade, R4 billion ($500 million) for the 2010 FIFA World Cup

stadium, R4.2 billion ($520 million) for the container harbor expansion at the port, R1.3 billion ($160 million) for the first phase of the bus-rapid-transit-system, and several billion rand for road and rail upgrades. Private sector Developments include further expansion of the Victoria & Alfred Waterfront, the Strand on Adderley development worth R2.5 billion ($310 million), the Media24 head office expansion, the Chevron refinery expansion, and development of the Old Mutual's Malgas building. The Malgas building will cost R137 million ($17 million) and, at 137 meters, will be among Africa's highest when finished. (Business Day, September 16, 2008)

Decision on Nuclear Project in Progress

¶12. (U) The procurement and investment decision process for the proposed Nuclear-1 pressurized water reactor (PWR) nuclear power stations are underway, state-owned power utility Eskom said on September 16, noting no decision had yet been taken. Eskom appealed to the media "and other interested parties" to allow space for the commercial process to unfold and be concluded. Eskom General Manager Brian Statham said on September 17 that the utility will reach a decision within the week. However, an Eskom spokesman said the company had not set a particular date for announcing a decision. "The process is well under way, we can't state any particular date. Our intention is to finalize the process by the end of the year,"

Fani Zulu said. Eskom was evaluating bids for the proposed nuclear power stations from two suppliers of PWR technology: the EPR Consortium led by Areva of France and the N-Powerment Consortium led by Westinghouse of the U.S. The EPR Consortium is offering two 1,650 MW EPR units for a total station capacity of 3,300 MW, while N-Powerment is officering three 1,140 MW AP1000 units for a total station capacity of 3,420 MW. Statham said Eskom had a number of potential locations for the power plants and the exact locations will depend on the type of plant chosen. (Engineering News, September 16-17, 2008)

Eskom to Unveil First Cogen Projects

¶13. (U) State power utility Eskom is expected to unveil the first cogeneration projects, forming part of the Pilot National Cogeneration Project (PNCP), by the end of this month, but it is unclear whether these projects would meet the initial 900 MW target. Speaking at the Cogeneration World Africa 2008 Conference in Johannesburg, on September 16, PNCP project leader Akash Prakash stressed the initiative was the forerunner to the larger, medium-term power purchase program (MTPPP), for which bids must be submitted by year-end. Eskom had previously reported receiving 15 cogeneration bids ahead of the PNCP's May 31 deadline. Together with the MTPPP, Eskom hopes to facilitate the introduction of about 3,000 MW of cogenerated power by 2012. Eskom has been given the controversial mandate as the country's "single buyer" of power arising from industrial facilities and potential new independent power producers. However, the National Energy Regulator of South Qpower producers. However, the National Energy Regulator of South Africa (NERSA) has objected to the arrangement and has called for the creation of an agency, separate from Eskom, to purchase power arising from the power sector. Eskom is still proceeding with both its PNCP and MTPPP and has let it be known that it is willing to contract at prices between 8-13 U.S. cents per kilowatt-hour (kwh) for 2009-2013, with prices falling progressively from 2014 to an eventual level of 5 U.S. cents per kwh in 2018 (it is not clear that a future reduction in pricing will be financeable). Industry and NERSA have criticized Eskom for not being receptive to practical and transparent arrangements for buying electricity from the private sector. (Engineering News, September 16, 2008)

PPC Hopes to Expand Plant
in Western Cape

¶14. (U) Cement Producer PPC has released the final 1,200-page environmental impact assessment (EIA) report for its planned R4 billion ($500 million) expansion and upgrade of the aging Riebeeck cement factory in the Western Cape Province. The new plant would have a capacity of around 1.3 million tons of cement per year,

according to PPC. Should the Western Cape Environmental Affairs Department approve the project, construction would start in mid-2009 and take three years to complete. Approval of the EIA is not a foregone conclusion, because there may be local or NGO opposition. Moreover, new EIA legislation is still under review by government. The new cement plant would be considerably more efficient than the existing plant, which produces 550,000 tons per year. The new plant would use less water, energy, and 30% less coal per ton of cement produced. PPC said bag filters would control dust emissions from the kilns stacks, limiting dust concentration in the cleaned gas to below the level of 50 milligrams per cubic meter, satisfying international and South African standards. Chief Operating Officer Orrie Fenn said the new plant was aimed at meeting the growing demand for cement in the Western Cape. South Africa's cement demand has grown by nearly 60% over the past five years and coupled with government's focus on infrastructure development, the Western Cape could face a shortage of cement in the next five years if production capacity is not increased, he said. (Engineering News, September 15, 2008)

SA Lays Out Its Hydrogen Economy

¶15. (U) The Department of Science and Technology (DST) revealed earlier that it had selected hydrogen and fuel cell technologies as key research themes under its frontier science and technology program. With South Africa possessing about 80% of the world's known platinum-group metal (PGM) reserves, and PGMs having applicability for fuel cells, the government felt there was a natural synergy. DST Minister Mosibudi Mangena argued that the link between PGMs and new energy alternatives had the potential to raise South Africa's strategic importance in the global economy. He made the remarks during the launch of the hydrogen and fuel technologies research, development, and innovation strategy, which was approved by the Cabinet last May. The strategy also proposes to build on existing knowledge of high-temperature, gas-cooled nuclear reactors and coal gasification and liquefaction technology to develop new cost-competitive hydrogen-generation solutions. Three centers of competence would be established to drive the various elements of the strategy. The Center of Competence for Catalyst would be jointly hosted by state-owned minerals research entity Mintek and the University of Cape Town. The University of the Western Cape would host the Center for Systems Integration and Validation, while the Council for Scientific and Industrial Research (CSIR) and the University of the North West would jointly host the Hydrogen Infrastructure Center of Competence (currently engaged in Pebble Bed Modular Reactor (PBMR) - related research). (Engineering News, September 17, 2008)

Cisco Builds ICT Innovation Center

¶16. (U) Cisco announced a R215 million ($27 million) investment to create an ICT innovation hub center in Gauteng Province. The Cisco Innovation Hub Technology Center (CIHTC) aims to develop skills, QInnovation Hub Technology Center (CIHTC) aims to develop skills, intellectual property, entrepreneurship, and solution development capabilities in the local ICT sector. These initiatives are expected to drive a R1 billion ($125 million) gross domestic product increase over an initial five-year period. Cisco South Africa MD Steve Midgley said the company was making this investment to ensure that South Africa had enough skills, solution creation capabilities, and intellectual property to benefit from broadband when the "revolution really kicks off". "South Africa is on the brink of entering a broadband boom," he noted. According to Midgley, this will change the way people live and work and should create an enabling platform from which new business models can be developed. The CIHTC is expected to create at least 200 direct and 800 indirect employment opportunities. Initiatives at the CIHTC will include a Global Talent Acquisition Program (GTAP), the Cisco Netversity, Entrepreneur Institute, and a software development program. The CITHC focuses on developing technology solutions to solve common business challenges in South Africa such as improving education and crime prevention strategies. GTAP aims to tackle the growing shortage of skilled networking professionals and has already absorbed the first group of students to create high-level network entrepreneurs at the Cisco Certified Internetwork Expert (CCIE) level. Cisco aspires to train at least 120 CCIE-level network

engineers over a five-year period for the local market, at its own cost. Netversity aims to develop 150 network design engineers through an experiential architecture and design program. The company also hopes to train 250 entrepreneurs through its Entrepreneur Institute. (Engineering News, September 15, 2008)

BOST